

JAN 24 1990

IN THE

Supreme Court of the United States

October Term, 1989

JAMES F. SPANIOL, JR.

CLERK

ROBERT COHEN, individually and as a Partner of SIMON COHEN REAL ESTATE & MANAGEMENT CO., SIMON COHEN REALTY CO., SIMON COHEN COMPANY and ALJER REALTY CO. suing on behalf of himself and all other partners, both general and limited, and in the right and on behalf of SIMON COHEN REAL ESTATE & MANAGEMENT CO., SIMON COHEN REALTY CO., SIMON COHEN COMPANY and ALJER REALTY CO., —

*Petitioner.**against*

ROBERT J. REED, SIDNEY HACKELL, BEATRICE POTTER and the FIRST NATIONAL CITY BANK, individually and as Executors of the Last Will and Testament of SIMON COHEN, deceased, WILLIAM B.F. WERNER, individually and doing business as MID-ISLAND HOSPITAL, JUAN SOTO, ELAINE WILSCHEK, J.S.K. CLEANING SERVICES, INC., JUDAH FEINERMAN, JASDANE, INC., SHELDON KATZ, VOLUME FEEDING, INC., DADGAB, INC., BRIMSCO, INC., SIMON COHEN REAL ESTATE & MANAGEMENT CO., SIMON COHEN REALTY CO. and ALJER REALTY CO.,

Respondents.

**PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF THE STATE
OF NEW YORK, APPELLATE DIVISION,
SECOND JUDICIAL DEPARTMENT**

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I

Question Presented

Is the due process clause of the Fourteenth Amendment violated when, in a derivative action, a state court intervenes in a trial to impose a settlement proposed by the defendants, where neither the sole representative plaintiff nor his attorney nor the derivative entity has consented to such settlement?



III

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Introduction

Petitioner Robert Cohen, individually and as a partner of Simon Cohen Real Estate & Management Co. ("SCREAM"), Simon Cohen Realty Co. ("SCR"), Simon Cohen Company ("SCC") and Aljer Realty Co. ("Aljer"), respectfully prays that a writ of certiorari issue to the Appellate Division, Second Judicial Department, of the Supreme Court of the State of New York to review its judgment and opinion entered in this proceeding on May 5, 1986.

Opinions Below

The opinion of the Appellate Division is reported at 120 A.D.2d 480, 501 N.Y.S.2d 685 (2d Dept. 1986) (mem.) and is reproduced at A-i. The Appellate Division's order affirmed a settlement decree of the Surrogate's Court of the State of New York, in respect of which an opinion was rendered by Radigan, Surr., on April 27, 1984. The Surrogate's opinion is unreported and is reproduced at A286.

References are to pages of the Appendix annexed to the petition.

Jurisdiction

The judgment of the Appellate Division, affirming a settlement decree of the Surrogate Court, was entered on May 5, 1986. Timely petitions to the Court of Appeals of the State of New York for leave to appeal to that Court were filed by the petitioner herein. Three of such petitions were dismissed for lack of jurisdiction in that, under the Constitution of the State of New York, the judgment appealed from was not a final order and therefore not appealable to the Court of Appeals. These dismissals were rendered without opinion and are reported at 68 N.Y.2d 807, 506 N.Y.S.2d 1037 (Sept. 16, 1986); 69 N.Y.2d 1038, 517 N.Y.S.2d 1031 (June 4, 1987); and 70 N.Y.2d 899, 524 N.Y.S.2d 427

(Dec. 17, 1987); and are reproduced at A401, A403 and A408. On May 9 and 10, 1988, the Surrogate's Court entered a supplemental decree (A455) and an order (A458) which resolved the remaining issues under its earlier decree and apparently satisfied the New York constitutional requirement of finality. Petitioner then moved again for leave to appeal to the Court of Appeals and that motion was denied by the Court of Appeals on October 26, 1989, without opinion. Such denial is not yet officially reported and is reproduced at A463. This Court's certiorari jurisdiction is invoked under 28 U.S.C. § 1257.

Constitutional Provisions

The Fourteenth Amendment to the United States Constitution provides, in relevant part:

...nor shall any State deprive any person of life, liberty, or property, without due process of law;...

Statutory Provisions

Section 115-a of the Partnership Law of New York provides, in relevant part:

1. An action may be brought in the right of a limited partnership to procure a judgment in its favor, by a limited partner, additional limited partner, or a substituted limited partner.

* * *

4. Such action shall not be discontinued, compromised or settled, without the approval of the court having jurisdiction of the action. If the court shall determine that the interests of the limited partners, additional limited partners or substituted limited partners, will be substantially affected by such discontinuance, compromise or settlement, the court, in its discretion, may direct that notice, by

publication or otherwise, shall be given to the limited, additional or substituted limited partners whose interests it determines will be so affected; if notice is so directed to be given, the court may determine which one or more of the parties to the action shall bear the expense of giving the same, in such amount as the court shall determine and find to be reasonable in the circumstances, and the amount of such expense shall be awarded as special costs of the action and recoverable in the same manner as statutory taxable costs.

Statement of the Case

Petitioner Robert Cohen sued individually and on behalf of four partnerships, SCREAM, SCR, SCC and Aljer, in Surrogate's Court, Nassau County, New York for an accounting, reformation of a lease and other relief. The complaint was based, in part, on the misappropriation of income from the four partnerships by the deceased managing general partner, Simon Cohen, acting in conjunction with the various individual and corporate defendants. The misappropriation also took the form of interest-free loans to the general partner as well as various schemes for siphoning income by assigning the right to perform various services used by the partnerships to certain of the defendants.

The two principal partnerships, SCR and its successor SCREAM, leased premises in Bethpage, New York to Dr. William Werner, starting in 1960. Under the lease arrangements, Dr. Werner operated a medical facility known as Mid-Island Hospital as a sole proprietorship at that site and agreed to pay the net profits of the Hospital to these partnerships as rent.

The Hospital was actually operated not by Dr. Werner, but by Simon Cohen, as the Hospital's managing director. Because Simon Cohen was also the general partner SCR and then of SCREAM, he should have vigilantly protected

the interests of those partnerships for whom he was a fiduciary. Instead, with the active assistance of many of the defendants, he improperly diverted hospital income for his own purposes and those of other defendants, thereby sharply reducing the rent paid to the partnerships. For example, in 1963, Simon Cohen caused the hospital to grant a concession for its gift shop, snack bar, vending machine and television rental services to his own cronies and caused the hospital to overpay for the services, to the prejudice of the rental income paid to the partnerships.

Also in 1963, Simon Cohen caused the hospital to "sell" to another Simon Cohen crony a cobalt machine that the hospital purchased a few months earlier, and thereafter to contract with the owner of the machine for its use. Profits from use of the machine were thereby diverted from the hospital and in turn from SCREAM; instead they wound up with another of Simon Cohen's close friends.

In 1964 the hospital's food services were spun off to respondent's Volume Feeding Inc., an entity owned and operated by cronies of Simon Cohen, which then overcharged the hospital for its purported food services.

Similarly, in 1967 the hospital entered into an agreement with J.S.K. Cleaning Services, Inc., a newly-formed corporation, whereby J.S.K., using the hospital's own former cleaning employees, was to provide maintenance services. J.S.K.'s profits on the maintenance contracts were then siphoned off to benefit Simon Cohen by having J.S.K. perform maintenance contracts for other entities owned by Simon Cohen.

In addition to using these siphoning devices, Simon Cohen also diverted income during the period 1965 through 1970 by borrowing millions of dollars, in approximately 200 separate transactions, from SCREAM, SCR, SCC and the Hospital. No interest was ever paid by Simon Cohen for use of these funds and no accounting was ever rendered by him. Many of these borrowings were paid at year-end, and the funds reborrowed at the start of the

succeeding year, in order to avoid disclosure of the loans on year end balance sheets of the partnerships and the hospital.

Robert Cohen's amended supplemental complaint asserted 17 causes of action. The first sixteen causes of action were asserted on behalf of the partnerships¹ and alleged that Simon Cohen borrowed funds from the partnerships without paying interest, disclosing the facts or obtaining the consent of his partners. They alleged that Simon Cohen had created various satellite companies, which he placed in the hands of trusted nominees, and manipulated their dealings for his purposes to the prejudice of his partners. They also alleged that the executors of the Estate of Simon Cohen attempted to cover up this misconduct by issuing false financial statements, testifying falsely and concealing the facts.

The action was commenced in Supreme Court, Nassau County, on August 13, 1971 and thereafter transferred to Surrogate's Court, Nassau County, on November 24, 1971. After a lengthy period of discovery, the trial commenced in Surrogate's Court on March 4, 1980 and extended for 55 trial days until October 22, 1981.

At that point, before petitioner had rested, the Surrogate intervened to force a settlement. The Surrogate refused to set any further trial dates and pressed the parties to agree to settle the case.

While the case was in limbo—with the trial stalled by the Court—a dispute then arose between petitioner and his then counsel of record, Stephen Hochhauser. Petitioner then moved in March 1983 for an order substituting new counsel and Hochhauser countered with a cross-motion seeking removal of Robert Cohen as a representative plaintiff on the ground that Cohen had allegedly had a conflict of interest. To resolve the substitution application and Hochhauser's claim, the Surrogate held four days of evidentiary hearings in the Fall of 1982, at which both

¹A seventeenth cause of action, asserting Robert Cohen's claim to be a general partner of SCREAM, was withdrawn with prejudice in 1985.

Robert Cohen and Hochhauser testified extensively. The result was a decision by the Surrogate dated January 18, 1983 in which he determined that the substitution should be made and that Hochhauser's charges of conflict of interest should be dismissed.

However, before these issues were decided and while Hochhauser's unfounded charges were still pending, the Surrogate requested on December 17, 1982 that the defendants present a settlement proposal. The defendants then delivered such a proposal to the Surrogate, *ex parte*, and on January 24, 1983 the Surrogate distributed notice of this proposal to the limited partners of the various limited partnerships. Only when he received this notice did Robert Cohen learn of the terms of the defendants' settlement proposal.

Responses from the limited partners to the Surrogate's notice came only from holders of a small minority of the partnership interests. Like defendants' proposal, these responses were received by the Surrogate *ex parte*; they were not disclosed to Robert Cohen until May 1983, after he learned of them and objected to their secret nature. The Surrogate then directed that a hearing be held on May 24, 1983 at which Robert Cohen and those who had objected show cause why the proposed settlement should not be approved.

At the May 24, 1983 hearing, the defendants presented no evidence in support of their proposal. Nevertheless, instead of dismissing the proposed settlement, the Surrogate on June 22, 1983 requested certain modifications to the proposal, indicating that these had been suggested by some of the limited partners' earlier written responses. The defendants then responded by indicating their acceptance of these certain modifications. Thereafter on January 6, 1984, the Surrogate proposed further modifications and gave the defendants time within which to consider and accept or reject them. Again the defendants accepted. The now twice modified settlement proposal was then approved by the Surrogate in a decision dated April 27,

1984 and was formalized in an order entered November 27, 1984. As approved, the settlement, although twice modified, was still similar to the defendants' December 1982 proposal.

In essence, the settlement decree provided that all of Robert Cohen's 16 derivative causes of action were dismissed, claims for an accounting or other relief were foreclosed, the defendants were to pay the partnerships approximately \$500,000 (an amount that was less than Cohen's actual litigation expenses) and the partners were granted some limited inspection rights for the future.

Throughout the period from December 1982, when the Surrogate requested the settlement proposal for the defendants, to November 1984, when he approved the proposal, Robert Cohen vigorously objected to the Court's procedure and to the proposal itself.

The claim of violation of due process was raised before the Surrogate in a motion for a new trial made on January 31, 1984 at pp. 9, 10 and 19 of the supporting affidavit and p. 5 of the supporting memorandum. For example, in the supporting affidavit, at p. 19, petitioner said:

"Because my rights to a speedy disposition of the case have been and continue to be violated, because there is scant of the trial before Judge Radigan being completed expeditiously, because the delay has prejudiced my rights to a fair trial and because I have been denied due process, the Court should order a new trial."

The due process claim was also raised in petitioner's brief on appeal to the Appellate Division, *inter alia* at p. 38-41:

"In every case known to counsel in which a class action or derivative action settlement has been approved, an actual settlement agreement was agreed to by either a representative plaintiff or a representative plaintiffs attorney. Counsel

have found no class action or derivative case, nor have any been cited by the Surrogate, in which a settlement was imposed without such an actual agreement.

* * *

In approving the settlement proposal over Robert Cohen's objection and without an agreement among counsel, the Surrogate disregarded the principle that one side's settlement proposal may not be imposed on the other side without its consent."

The issue was also raised in petitioner's fourth motion for leave to appeal to the Court of Appeals at pp. 11 and 12 of the supporting affidavit.

Certiorari Should be Granted

Certiorari should be granted because the order of the Appellate Division violates the due process rights of petitioner. It establishes a completely new—and improper—procedure for the settlement of derivative actions, in violation of the fundamental rule that a settlement requires the consent of the parties on *both* sides. The Appellate Division's order is completely without precedent. We believe it is the first reported appellate decision anywhere, whether in New York, other states or the federal system, in which a settlement is imposed in a derivative case even though neither the sole representative plaintiff nor his counsel (nor the entity on whose behalf suit is brought) has agreed to the settlement.

Due process expresses the requirement of "fundamental fairness" and is not a mere technical conception. *Lassiter v. Department of Social Services of Durham County*, 452 U.S. 18, 24 (1981); *Cafeteria & Restaurant Workers v. McElroy*, 367 U.S. 886, 895 (1961).

The constitutional guarantee of due process recognizes that minimum procedural requirements are a matter of

federal law and are not diminished by the fact that the state may have its own procedures that it may deem adequate for determining the preconditions to adverse official action. *Logan v. Zimmermann Brush Co.*, 455 U.S. 404, 432 (1982). As a matter of federal constitutional law, the state may not finally destroy a property interest without first giving the putative owner an opportunity to present his claim of entitlement. *Id.* at 434. While the nature of the required hearing will depend on the appropriate accommodation of the competing interests involved, *id.*, where the state acts only as the adjudicator of a genuine and well-founded dispute between private parties, its interest in terminating a private litigant's right to a trial is minimal. And where the trial is already in progress, the state has no valid interest in terminating the trial by imposing an involuntary "settlement" simply because the proceedings prove to be lengthy or the issues are discovered to be complex.

The procedure followed by the Surrogate in this case violates petitioner's due process rights because he, not the trial court, has the right to conduct the litigation on behalf of the partnerships and to negotiate settlements. Under the Appellate Division decision, the trial judge was permitted to substitute his view for the view of both the representative plaintiff and his counsel, even where, after an extensive hearing, the court has rejected allegations that the representative plaintiff was acting improperly.

The Appellate Division decision erroneously relies upon the court-solicited "consent" of some of the limited partners, none of whom is a party or representative plaintiff, or otherwise appeared in the proceeding. These limited partners, as non-parties, have no fiduciary responsibility for the course of the litigation and have no power to reach a binding settlement agreement. State courts cannot circumvent the rights of a party to conduct litigation by the device of soliciting such "consents" from non-parties whose interests are indirect and whose knowledge is highly limited. Although in class actions lower courts have

held that approval by class members is a relevant, albeit a minor, factor in evaluating a settlement, prior to the decision below no court had ever held such approval to be sufficient to create a settlement agreement in a derivative action where neither the representative plaintiff nor his counsel nor the entity they represent had agreed to the defendants' proposal.

The Appellate Division attempted to support its decision by referring to allegations of Robert Cohen's supposed conflict of interest. But the Surrogate had already ruled that those charges were not substantiated and should be dismissed. (A205).

Due process does not permit a trial court to impose on petitioner, as the sole representative, a settlement that neither he nor his attorney nor the plaintiff he represents has agreed to. Unless there is an actual settlement agreement negotiated between the parties (and not simply a proposal by the defendants which is "consented to" by some non-party beneficiaries), the procedure approved by the Appellate Division deprives this petitioner, and threatens to deprive all similarly situated representative plaintiffs, of the right to a fair hearing.

The Appellate Division's unconstitutional determination has broad implications both for the state and federal court systems. It effectively means that the trial courts are empowered in derivative actions to disregard the wishes of the parties and their lawyers on one side of the table and to impose settlements proposed by the other side. To be sure, the Surrogate did solicit the views of non-parties who had interests in the partnerships. But they were not parties, had no fiduciary obligations, and were not in any position to evaluate the case properly.

Unlike a class action, where settlements have been imposed over the wishes of class members, those class members have the right, mandated by the due process clause, to opt out of the settlement. Here, Robert Cohen, the only plaintiff on behalf of the partnerships, had no right to opt out, but was forced by the Surrogate and the

Appellate Division to abide by a settlement to which he and his lawyer vigorously objected.

This case is unlike a few lower court cases where the views of one or more nominal representative plaintiffs were overridden because they were not the real parties in interest. In this case, the real party in interest is Robert Cohen. Not only did he serve as the sole representative plaintiff, but he also paid well in excess of \$600,000 in legal fees in support of the litigation and he actively participated in reviewing all papers, preparing for all hearings and deciding upon the relevant legal strategies. In no sense was he a nominal plaintiff and therefore when his rights to a trial were abrogated without his assent or the assent of his lawyer, he suffered a direct injury to his constitutional rights as a litigant.

Review is needed to prevent a miscarriage of justice. Overwhelming evidence of waste and fraud by the defendants was established during the trial. Vast sums were taken from the partnership by Simon Cohen as interest-free loans. Other vast sums were siphoned out of the partnerships' income stream through the use of service companies created for Simon Cohen's cronies. Yet without the consent of the sole representative plaintiff or his counsel, a settlement was imposed in which the recovery by the partnerships will be less than the actual legal fees paid by the representative plaintiff and where the clearly established malfeasance of the defendants is excused without any accounting.

The Supreme Court of the United States has never directly addressed the question of the power of a court in a derivative action to impose a settlement in the absence of an agreement among the litigants. Because the Appellate Division's decision is a significant precedent with nationwide implications and because it resulted in a denial of due process and a miscarriage of justice, this Court should grant certiorari to consider the question presented.

Conclusion

For the foregoing reasons, petitioner respectfully prays that his petition for a writ of certiorari be granted.

Dated: January 22, 1990

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